North American Accounting Studies
Vol. 1, No. 1
2018
PP 17-36

# From *Bellas Hess* to *Wayfair*: An Analysis of Supreme Court Jurisprudence on the Physical Presence Rule

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## Abstract

For 51 years, the physical presence rule has hampered states in collecting sales and use taxes from sellers with no property or personnel within state borders. The U.S. Supreme Court established this rule in 1967 in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, based on the formalistic Due Process Clause and dormant Commerce Clause jurisprudence of that time, under which states had no authority to tax interstate commerce. However, in 1992, the Court upheld the physical presence rule under the dormant Commerce Clause in *Quill Corporation v. North Dakota*, notwithstanding dramatic changes in dormant Commerce Clause jurisprudence and the economy. On June 21, 2018, the Supreme Court rejected the physical presence rule in *South Dakota v. Wayfair* as anachronistic, unfair, and out of touch with the modern economy. This change will finally allow states to collect sales and use tax from remote sellers.

Keywords: state tax, sales tax, use tax, physical presence, remote seller, remote sale, Internet sale, interstate commerce, dormant Commerce Clause, due process, Bellas Hess, Quill, Wayfair.

## Introduction

States have long had their hands tied in collecting sales and use taxes[1] from out-of-state sellers that use the Internet and mail order to reach customers inside of their state. For over 50 years, the U.S. Supreme Court's dormant Commerce Clause jurisprudence[2] has required that an out-of-state seller have a "physical presence" through tangible or real property or personnel within the borders of the state for the state to have the authority to impose sales taxes or the requirement to collect use taxes on the seller.[3] While the physical presence rule may not have

[1] Sales taxes and use taxes are a complementary system states employ to collect as a tax a percentage of sales made to customers in-state. *South Dakota v. Wayfair, Inc.*, No. 17-494 (June 21, 2018) (slip opinion) at 7. Sellers are required to collect the sales tax at the time of sale from the customer and remit it to the state. Id. If the seller does not collect the sales tax, the customer is required to pay use tax, an amount equal to the sales tax, directly to the state. Id. However, consumer compliance with use tax requirements is "notoriously low." *Id.*, citing GAO, "Report to Congressional Requesters: Sales Taxes, States Could Gain Revenue from Expanded Authority, but Businesses Are Likely to Experience Compliance Costs," GAO-18-114, at 5 (Nov. 2017).

[2] The Commerce Clause grants Congress power to "regulate Commerce . . . among the several States." U.S. Const. Art. I, § 8, cl. 3. The dormant Commerce Clause, though not an express part of the Commerce Clause, is a judicially created doctrine that prevents states from imposing undue burdens on interstate commerce. See *Gibbons v. Ogden*, 22 U.S. 1, 199-205, 9 Wheat. 1, 6 L.Ed. 23 (1824) (first recognizing the power of states to regulate and tax subject to limitation of burdening interstate commerce under the Commerce Clause). The courts have interpreted the dormant Commerce Clause to mean that states cannot impose taxes or take any other action that will interfere or discriminate against commerce among the states. (Howsare 2017)

[3] The physical presence rule appears to have been limited to the collection of sales and use taxes. The Supreme Court has not applied the physical presence rule to other types of state taxes and has also not accepted certiorari in

had a major effect on sales and use tax revenues collected by states 50 years ago when the mail order industry was limited and the Internet did not exist, the increasing growth of commerce by remote sellers,[4] particularly due to the explosive development of Internet sales, has exponentially increased the physical presence rule's negative impact on state's tax revenues. (Thimmesch 2011/2012)

That all changed on June 21, 2018 when the Supreme Court issued its opinion in *South Dakota v. Wayfair*.[5] In that case, the Supreme Court rejected the physical presence rule and overturned the two cases responsible for its long life, *National Bellas Hess v. Department of Revenue of the State of Illinois*,[6] and *Quill Corporation v. North Dakota*.[7] In *Wayfair*, the Supreme Court recognized states' sovereignty and authority to tax remote sellers doing substantial business with customers inside state borders and restored equity to the application of sales and use taxes on both in state and remote sellers. The Court's rejection of the physical presence rule will allow states to dramatically increase collection of sales and use tax revenues from remote sellers within the reasonable boundaries of the dormant Commerce Clause.

At the time *Bellas Hess* was decided, the dormant Commerce Clause jurisprudence was formalistic, such that the Court was virtually required to hold that an in-state physical presence was necessary to impose state sales and use taxes on a seller. When *Quill* was decided in 1992, the Court's jurisprudence in this area had dramatically changed providing for a more functional and realistic analysis; nonetheless, the *Quill* Court upheld the physical presence rule under the doctrine of *stare decisis*[8] and practical concerns about the application of state sales and use taxes to remote sellers. Now, not only is the Court's dormant Commerce Clause jurisprudence flexible, the economy of the nation has dramatically changed. This compelled the Court to reject the physical presence rule and overturn *Bellas Hess* and *Quill* in *Wayfair*.

There are repeating legal issues in all three decisions, sometimes relied upon in the majority opinion and sometimes by the dissenters. These include:

- whether formalism or functionalism should govern dormant Commerce Clause analysis;
- whether violations of the Due Process Clause and burdening interstate commerce are similar or could be distinguished;
- whether the doctrine of *stare decisis* compels maintenance of the rule;

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any state case addressing that issue. However, in *Quill Corporation v. North Dakota*, the Court appeared to limit the physical presence rule to sales and use taxes. 504 U.S. 298, 317, 112 S.Ct. 1904, 119 L.Ed. 2d 91 (1992). (Swain I 2003) Other commentators have argued that the Supreme Court's lack of action in this area means that the physical presence rule should be applied to other state taxes. (Murtha 2013) However, the majority of state courts have held that the physical presence rule applies only to sales and use taxes and not to other types of state taxes. (Thimmesch 2011/2012) Because of the Wayfair decision, however, that issue is now moot.

[3] U.S., No. 17-494 (June 21, 2018).

[4] This article uses the term "remote sellers" to mean out-of-state sellers with no physical presence in a state, as defined in *National Bellas Hess v. Department of Revenue of the State of Illinois*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed. 2d 505 (1967), and its progeny.

[5] U.S., No. 17-494 (June 21, 2018).

[6] 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed. 2d 505 (1967).

[7] 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed. 2d 91 (1992).

[8] *Stare decisis* is Latin for "to stand by decided matters." (Meriam-Webster Law Dictionary 2018) The doctrine of *stare decisis* provides a strong motivation to courts to apply and abide by precedent and not disturb settled issues. While the doctrine does allow for change in certain situations, the courts consider (1) whether there has been a major change in related areas of the law; (2) whether there has been a factual change in the economy, the culture, technology, and other aspects of society; (3) whether the precedent is now unworkable; and (4) whether strong reliance interests exist that would be harmed by a change in the law. (Swain II 2003)

- whether the absence of the physical presence rule would unduly burden remote sellers with the administrative requirements of complying with state and local taxes;
- whether the rule resulted in tax distortion, unfairly penalized in-state sellers, and constituted a judicially created tax shelter;
- whether the changes in technology and the economy have made the rule obsolete; and
- whether any or all of these issues should be left to Congress.

The Court's changing analysis of the physical presence rule was also impacted by other cases involving the dormant Commerce Clause's effect on state taxation, especially *Complete Auto Transit, Inc. v. Brady*[9] and *National Geographic Society v. California Board of Equalization*.[10]

This article examines the Court's varying findings on the validity of the physical presence rule from 1967 to today and predicts how the *Wayfair* ruling will change the analysis on whether states' taxation of remote sellers violates the dormant Commerce Clause.

## The Establishment of the "Physical Presence" Rule

### *National Bellas Hess, Incorporated v. Department of Revenue of the State of Illinois*

The physical presence rule originated in *Bellas Hess*.[11] National Bellas Hess, Inc. ("Bellas Hess") was a mail order house that sold millions of dollars in goods to Illinois residents.[12] It was incorporated in Delaware with its principal place of business in Missouri.[13] Bellas Hess had no offices, distribution houses, sales houses, warehouses, or any other place of business in Illinois.[14] It had no personnel in Illinois to sell or take orders or to service the merchandise it sold.[15] It did not own any tangible property in Illinois and did not advertise in newspapers or on billboards, radio, or television in Illinois.[16] The only contacts Bellas Hess had with Illinois were through U.S. mail and common carrier.[17] It sent catalogues by mail to Illinois customers (as well as its other customers nationwide) twice a year and occasionally mailed advertising flyers.[18] In order to purchase goods, customers mailed orders to Bellas Hess at its Missouri plant, and Bellas Hess would fill the orders, shipping the goods by mail or common carrier.[19]

The Illinois Department of Revenue sought to require Bellas Hess and similar remote sellers to collect use taxes from its customers and remit them to the state under Section 3 of the

[9] 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977).
[10] 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977).
[11] The *Bellas Hess* Court did not use the words "physical presence" to describe the rule. These words were used in later cases. See, e.g., *National Geographic*, 430 U.S. at 556 (stating that appellant's two offices and employees in-state constituted "a much more substantial presence than the expression 'slightest presence' connotes."); *Quill*, 504 U.S. at 314-315 (1992) (calling it the "physical-presence requirement" from *Bellas Hess*, which it described as a "bright-line test.")
[12] *Bellas Hess*, 386 U.S. at 760-61 (J. Fortas, dissent) ("Its sales in Illinois amounted to $2,174,744 for the approximately 15 months for which the taxes in issue in this case were assessed.")
[13] *Id.*, 386 U.S. at 753-54.
[14] *Id.*, 386 U.S. at 754, quoting *Department of Revenue v. National Bellas Hess, Inc.*, 34 Ill. 2d 164, 166-67 (1966).
[15] *Bellas Hess*, quoting 34 Ill. 2d at 167.
[16] *Id.*
[17] *Bellas Hess*, 386 U.S. at 754.
[18] *Id.*
[19] *Id.*, 386 U.S. at 754-55.

Use Tax Act in effect at that time in Illinois.[20] Under that section, "[e]ngaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State," was enough to classify the seller as a "retailer maintaining a place of business in this State."[21] In other words, under the statute, any retailer that solicited orders in Illinois, whether physically located in Illinois or not, was deemed to maintain a place of business in Illinois. These retailers, including Bellas Hess, were required to collect and remit use taxes from its Illinois customers, provide receipts to their customers, keep detailed records, and submit themselves to the jurisdiction of the Department of Revenue and Illinois courts, with the Illinois Secretary of State designated as their appointed agent for service of process.[22]

After Bellas Hess failed to collect and remit the use tax, the Department sued to resolve whether it was responsible for collecting and remitting the use tax. The trial court entered summary judgment in favor of the Department for $93,242.18, representing taxes of $74,593.75 assessed under the Use Tax Act for the 15-month period, plus a 25% penalty of $18,648.43.[23] The Illinois Supreme Court affirmed the trial court's judgment.[24] On appeal to the U.S. Supreme Court, Bellas Hess argued that the application of the Illinois statute against it violated the Due Process Clause of the Fourteenth Amendment and created an unconstitutional burden on interstate commerce under the dormant Commerce Clause.[25]

In the majority opinion, the Court found that the tests for violations of the Due Process Clause and unduly burdening interstate commerce were similar.[26] The Court determined that a state tax imposed on interstate commerce would be justified only to the extent that the interstate business bears its share of the cost of the local government "whose protection it enjoys."[27] The Court described the test for determining whether a state tax violates due process as "whether the state has given anything for which it can ask return."[28] The Court determined that the same question in the due process test could be applied to the power of a state to impose burdens of collecting use tax on interstate sales.[29] It found that in both tests, the Constitution required a minimum connection between the state and the transaction it seeks to tax.[30]

The *Bellas Hess* Court outlined the previous instances in which it had upheld a state's right to impose a duty to collect a state use tax from an out-of-state seller: (1) when the out-of-state seller had a local agent in the taxing state that arranged the sales[31]; (2) when a mail order seller maintained local retail stores[32]; and (3) when the out-of-state seller had 10 employees conducting continuous solicitation in one state who forwarded the orders from that state to

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[20] *Id.*, 386 U.S. at 755, citing Ill. Rev. Stat. chap. 120, §439.2 (1965).
[21] *Id.*, quoting Ill. Rev. Stat. chap. 120, §439.2 (1965).
[22] *Id.*, 386 U.S. at 755-56.
[23] *Department of Revenue*, 34 Ill.2d 164, 214 N.E.2d 755, 756 (1966).
[24] *Bellas Hess*, 386 U.S. at 753.
[25] *Id.*, 386 U.S. at 756.
[26] *Id*.
[27] *Id.*, quoting *Freeman v. Hewit*, 329 U.S. 249, 253, 67 S. Ct. 274, 277, 91 L.Ed. 2d 265 (1946).
[28] *Bellas Hess*, quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444, 61 S.Ct. 246, 250, 85 L.Ed. 2d 267 (1940).
[29] *Id.*, 386 U.S. at 756.
[30] *Bellas Hess*, citing *Miller Bros. Co. v. State of Maryland*, 347 U.S. 340, 344-45, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954) and *Scripto, Inc. v. Carson*, 362 U.S. 207-210,211, 80 S.Ct. 619, 621-622, 4 L.Ed. 2d 660 (1960).
[31] *Bellas Hess*, 386 U.S. at 757, citing *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62, 59 S.Ct. 376, 83 L.Ed. 488 (1939); *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335, 64 S.Ct. 1028, 88 L.Ed. 1309 (1944).
[32] *Bellas Hess*, citing *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 61 S.Ct. 58, 85 L.Ed. 888 (1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373, 61 S.Ct. 593, 85 L.Ed. 897 (1941).

another state for shipment.[33] In all of these cases, the Court noted, the out-of-state sellers maintained personnel or tangible personal or real property in the taxing state. The Court determined that it had never held that a state could impose a requirement that an out-of-state seller collect use taxes if that seller's only connection with customers in that state was by mail or common carrier.[34]

Because Bellas Hess had no property or personnel of any kind in Illinois and its only connections with its customers in Illinois were by mail and common carrier, the Court held that Bellas Hess's activities in Illinois were exclusively interstate and subject only to Congressional regulation and not state taxes.[35]

The Court also opined that, if Illinois were allowed to impose use tax burdens on Bellas Hess, every other state, municipality, school district, and local taxing body could also do so.[36] Such "local entanglements" were not unjustified under the Commerce Clause.[37] The Court held that the Illinois statute violated the Due Process Clause and placed an unconstitutional burden on interstate commerce in violation of the Commerce Clause.

Justice Fortas, joined by Justices Black and Douglas, dissented.[38] He asserted that Court precedent[39] and "a realistic approach"[40] to the facts required the Court to affirm the Illinois Supreme Court.[41] The dissent focused on the quantity of Bellas Hess's sales in Illinois, the large number of Illinois residents who received catalogues twice a year, and even greater number of Illinois residents who received Bellas Hess's flyers.[42] Justice Fortas argued that Bellas Hess's advertising and sales solicitations were large-scale, systematic, and continuous, and constituted exploitation of the Illinois consumer market.[43]

The dissent also argued that Bellas Hess offered credit to Illinois residents with which to finance their purchases and a charge account, both of which required the applicant to provide bank information.[44] Justice Fortas opined that it would be reasonable to assume that Bellas Hess either sold, assigned, or otherwise collected on its delinquent accounts, which would require the company, its assignees, or representatives to conduct activities within the state.[45] Bellas Hess's solicitations and the use of residents' credit resources, which were dependent on the State's

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33 *Bellas Hess*, 386 U.S. at 757-58, quoting *Scripto.*
34 *Bellas Hess*, 386 U.S. at 758 ("In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities, is a valid one, and we decline to obliterate it.").
35 *Id.*, 386 U.S. at 759 ("Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved.").
36 *Id.*, 386 U.S. at 759-60.
37 *Id.*, 386 U.S. at 760.
38 *Id.*, 386 U.S. at 761-766 (Fortas, J., dissenting).
39 *Scripto*, supra, n. 30.
40 Here, Justice Fortas distinguished between the formalistic analysis conducted by the *Bellas Hess* majority and a realistic analysis that took into account the extent of *Bellas Hess's* involvement in the state.
41 *Id.*, 386 U.S. at 760 (Fortas, J., dissenting).
42 *Id.*
43 *Id.*, 386 U.S. at 761 (Fortas, J., dissenting).
44 *Id.*, 386 U.S. at 761-62 (Fortas, J., dissenting).
45 *Id.*, 386 U.S. at 762 (Fortas, J., dissenting)

banking and credit institutions, he argued, constituted a sufficient nexus[46] with Illinois to require Bellas Hess to comply with Illinois' use tax collection requirements.[47]

Finally, Justice Fortas argued that excusing companies like Bellas Hess from the use tax collection requirements of the state burdened and penalized in-state retailers required to collect sales tax from their customers,[48] and that any burden on Bellas Hess from compliance with Illinois and local law was no greater than the burden on in-state retailers.[49] Further, the dissent noted that Illinois reimbursed remote sellers subject to the statute for their use tax collection duties by providing a discount of two percent or $5, whichever larger, each calendar year, which meant that Bellas Hess would be compensated for the administrative costs of collecting the tax and remitting it to the state.[50]

## Important Cases Decided Between *Bellas Hess* and *Quill*

In 1977, the Supreme Court decided two cases that further analyzed state taxation under the dormant Commerce Clause, *Complete Auto Transit, Inc. v. Brady*[51] and *National Geographic Society v. California Board of Equalization*.[52] Neither of these cases dealt specifically with sellers that had no physical presence within the taxing state, but they developed the Supreme Court's jurisprudence in related ways.

### *Complete Auto Transit, Inc. v. Brady*

At the time *Bellas Hess* was decided, the Court's Commerce Clause jurisprudence included a formalistic blanket prohibition on any state taxation imposed directly on interstate transactions, which was established in *Freeman v. Hewit,*[53] and the *Spector* rule, developed in *Spector Motor Service v. O'Connor*[54] in reliance on *Freeman* and *Memphis Gas Co. v. Stone*.[55] The *Spector* rule stood for the proposition that a state's taxation of purely interstate commerce on the "privilege of doing business" in the state was unconstitutional.[56] In *Complete Auto*, the Court reconsidered both of these rules.

The *Complete Auto* Court determined that, notwithstanding the apparent adoption of absolute immunity for interstate commerce from state taxation in *Freeman*, the Court had moved

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[46] Justice Fortas defined sufficient nexus as " 'Some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *Bellas Hess*, 386 U.S. at 765 (Fortas, J., dissenting), quoting *Miller Bros. Co. v. State of Maryland*, 347 U.S. 340, 344, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954).
[47] *Bellas Hess*, 386 U.S. at 761-62 (dissent, J. Fortas) ("There should be no doubt that this large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient 'nexus' to require Bellas Hess to collect from Illinois customers and to remit the use tax, especially when coupled with the use of the credit resources of residents of Illinois, dependent as that mechanism is upon the State's banking and credit institutions."
[48] *Bellas Hess*, 386 U.S. at 763.
[49] *Id.*, 386 U.S. at 766.
[50] *Id.*, 386 U.S. at 764, n. 7 (Fortas, J., dissenting), quoting Ill. Rev. Stat. chap. 2, §439.9 (1965).
[51] 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977).
[52] 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977).
[53] 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 2d 265 (1946). The *Bellas Hess* Court cited *Freeman* for the proposition that the taxation of interstate commerce by a state can be justified only if designed to make that commerce " 'bear a fair share of the cost of the local government whose protection it enjoys.' " *Bellas Hess*, 386 U.S. at 756, quoting *Freeman*, 329 U.S. at 253.
[54] 340 U.S. 602, 71 S.Ct. 508, 95 L.Ed. 2d 573 (1951).
[55] 335 U.S. 80, 68 S.Ct. 1475, 92 L.Ed.2d 1832 (1948).
[56] *Complete Auto*, 430 U.S. at 284.

towards permissibility of state taxation based on actual effect rather than formalistic requirements.[57] In support, the Court described its decision in *Colonial Pipeline Co. v. Traigle*,[58] in which it found that merely doing business in interstate commerce does not exempt corporations from state taxation, and foreign corporations conducting exclusively interstate business can be subject to state tax when the tax relates to the corporation's local activities and benefits and protections that have been provided by the state to the corporation for which the state is justified in seeking a fair and reasonable return.[59] The Court also rejected the *Spector* rule as unduly formalistic and instead adopted a four-prong test for Commerce Clause challenges to state taxation of interstate commerce.[60]

The appellant in that case, Complete Auto Transit, Inc. ("Complete Auto") was engaged in the business of transporting cars by truck to Mississippi dealers.[61] The Mississippi State Tax Commission assessed Complete Auto a tax on the "privilege of doing business" within the state equal to five percent of the gross income of that business to be collected by adding it to the gross sales price for collection at the time the sales price is collected.[62] The company argued that, under the *Spector* rule, the application of the tax on the privilege of doing business was unconstitutional because its activities in the state were purely interstate commerce.[63]

The Court rejected that argument and determined that the *Spector* rule created a situation in which "magic words or labels" in a tax statute, specifically that statute imposed the tax on the "privilege of doing business," could result in an otherwise constitutional tax being rejected under the dormant Commerce Clause.[64] It stated that the *Spector* rule operated only as a drafting rule, which distracted courts and parties from inquiring into whether the tax placed an undue burden on interstate commerce.[65] The Court determined that the rule demonstrated an underlying philosophy that interstate commerce had free trade immunity from state taxation.[66] The Court rejected the formalism of the *Spector* rule and overturned the cases that resulted in this rule.[67]

To replace the *Spector* rule, the Court established a four-prong test to determine whether state taxation of interstate commerce met the requirements of the Commerce Clause.[68] If the tax: (1) was applied to an activity that had a substantial nexus with the state; (2) was fairly apportioned; (3) did not discriminate against interstate commerce; and (4) was fairly related to the services provided by the state, the tax was constitutional.[69] This four-prong test continues to be applied in current dormant Commerce Clause cases involving state taxation.

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[57] *Id.*, 430 U.S. at 281. This finding mirrored Justice Fortas' argument in his *Bellas Hess* dissent that formalism should give way to a "realistic approach." *Bellas Hess*, 386 U.S. at 760 (Fortas, J., dissenting).
[58] 421 U.S. 100, 108, 95 S.Ct. 1538, 1543, 44 L.Ed.2d 1 (1975).
[59] *Complete Auto*, 430 U.S. at 287-288, quoting *Colonial Pipeline*, 421 U.S. at 108. See also *Goldberg v. Sweet Gte Sprint Communications Corporation v. Sweet*, 488 U.S. 252, 259, 109 S.Ct. 582, 102 L.Ed.2d 607 (1989) (*Complete Auto* specifically rejected "the view that the States cannot tax interstate commerce, while at the same time placing limits on state taxation of interstate commerce.")
[60] *Complete Auto*, 430 U.S. at 279.
[61] *Id.*, 430 U.S. at 276.
[62] *Id.*, 430 U.S. at 275-76.
[63] *Id.*, 430 U.S. at 277-78.
[64] *Id.*, 430 U.S. at 284, quoting *Railway Express Agency v. Virginia*, 358 U.S. 434, 79 S.Ct. 411, 3 L.Ed. 2d 450 (1959).
[65] *Id.*, 430 U.S. at 285.
[66] *Id.*, 430 U.S. at 278.
[67] *Id.*, 430 U.S. at 288-89.
[68] *Id.*, 430 U.S. at 279.
[69] *Id*.

### *National Geographic Society v. California Board of Equalization*

In *National Geographic*, the Court held that the Due Process Clause and the Commerce Clause were not violated when California imposed a requirement on the National Geographic Society, which sold maps, books, and other items to California residents by mail order, to collect and remit use taxes.[70] National Geographic had two offices and employees in California that solicited advertising for its magazine, but were not involved in any activities related to the mail order sales.[71] The Court held that the presence of these offices and personnel provided a sufficient nexus for the state to collect and remit use taxes even on sales to which the offices were not connected.[72] The Court distinguished *Bellas Hess* because there the seller had no physical presence of any kind in Illinois, unlike National Geographic in California.[73]
The *National Geographic* case clarified the *Bellas Hess* ruling by showing that *any* physical presence, whether related to the activities of the seller that were subject to state tax or not, was sufficient to bring that seller within the state's taxing jurisdiction.

## The First Direct Challenge to the Physical Presence Rule

### *Quill Corporation v. North Dakota by and through Heitkamp*

In 1992, 25 years after *Bellas Hess* and 15 years after *Complete Auto* and *National Geographic*, the Supreme Court revisited the physical presence rule. On facts virtually identical to *Bellas Hess*, the Court considered whether an out-of-state mail-order house with no in-state property, employees, or agents, that is, no physical presence, was subject to state law imposing a use tax on goods purchased state residents in *Quill Corporation v. North Dakota by and through Heitkamp*.[74]

Quill was a Delaware corporation that sold office equipment and supplies and had offices and warehouses in Illinois, California, and Georgia.[75] It had no physical presence in North Dakota, where it solicited sales through catalogues and flyers, advertisements in national magazines, and telephone calls.[76] It was the sixth largest office supply vendor in North Dakota, with almost $1 million in sales and 3,000 customers in North Dakota, and delivered all of the items sold to North Dakota residents by mail and common carrier.[77]

North Dakota attempted to impose a duty to collect and remit a use tax on Quill under a state statute that required every "retailer" maintaining a place of business in the state to collect and remit the tax.[78] "Retailer" was defined in the North Dakota statute as "every person who

[70] *National Geographic*, 430 U.S. at 556.
[71] *Id.*, 430 U.S. at 552.
[72] *Id.*, 430 U.S. at 556, 561 ("Here the Society's two offices, without regard to the nature of their activities, had the advantage of the same municipal services, fire and police protection, and the like as they would have had if their activities … included assistance to the mail-order operations that generated the use taxes.").
[73] *Id.*, 430 U.S. at 560.
[74] 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed. 2d 91 (1992).
[75] *Quill*, 504 U.S. at 302.
[76] *Id.*
[77] *Id.*
[78] *Id.*, quoting N.D.Cent. Code §57-40.2-07 (Supp. 1991).

engages in regular or systematic solicitation of a consumer market in th[e] state."[79] "[R]egular or systematic solicitation" was defined as three or more advertisements in a 12-month period.[80]

North Dakota, by its tax commissioner, filed an action to compel Quill to pay taxes, interest, and penalties on sales to state residents made after July 1, 1987.[81] The trial court ruled in Quill's favor, citing *Bellas Hess* in finding that the state did not show that it spent its revenues for the benefit of Quill's sales in North Dakota; thus, there was no nexus with the state.[82]

The North Dakota Supreme Court reversed the trial court and held that the huge changes in social, commercial, economic, and "legal innovations" since 1967, particularly technical changes and increases in the volume of mail order business, made *Bellas Hess* obsolete.[83] The "legal innovations" mentioned by the court included the Supreme Court's dormant Commerce Clause analyses in *Complete Auto*[84] and *National Geographic*.[85]

The North Dakota Supreme Court also asserted that Supreme Court cases following *Bellas Hess* did not require physical presence for the minimum contacts test for due process.[86] It argued that instead the Court has considered whether the out-of-state retailer has purposefully directed its activities at a state's residents in determining whether the retailer has minimum contacts with the state.[87] The court determined that Quill's lack of physical presence in the state was not fatal to the state's attempt to impose a requirement to collect and remit use taxes on Quill.[88] The court ruled that the use tax as applied to Quill satisfied the four-prong test in *Complete Auto* and did not violate the Due Process Clause or the Commerce Clause.[89]

On appeal to the U.S. Supreme Court, the Court reversed the North Dakota Supreme Court, finding that the dormant Commerce Clause analysis in *Bellas Hess* was not obsolete.[90] First, though the *Bellas Hess* Court described the Due Process Clause test and the Commerce Clause test as "similar," [91] the *Quill* Court distinguished them, finding they each developed distinct limits on the state taxing powers and differed in several fundamental ways.[92] The Court determined that while a State may have the authority to tax a remote seller under the Due Process Clause, the tax may violate the Commerce Clause.[93]

### Overturning *Bellas Hess's* Due Process Analysis

The Court asserted that in *Bellas Hess*, due process required a seller's physical presence in a state before the state could impose a tax on that retailer.[94] However, it found that the Court's

[79] *Quill*, 504 U.S. at 302-303, quoting N.D.Cent. Code §57-40.2-01(6) (Supp. 1991).
[80] *Quill*, 504 U.S. at 303, quoting N.D.Admin. Code §81-04.1-01-03.1 (1988).
[81] *Quill*, 504 U.S. at 303.
[82] *Id.*.
[83] *State By and Through Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 208 (N.D. 1991).
[84] 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977).
[85] 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977).
[86] *Heitkamp*, 470 N.W.2d at 212, 213, quoting *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472-473, 105 S.Ct. 2174, 2182, 85 L.Ed.2d 528, 540-541 (1985).
[87] *Heitkamp*, 470 N.W.2d at 212.
[88] *Id.*, 470 N.W.2d at 215.
[89] *Id.*, 470 N.W.2d at 219.
[90] *Quill*, 504 U.S. at 319.
[91] *Bellas Hess*, 386 U.S. at 756.
[92] *Quill*, 504 U.S. at 305.
[93] *Id.*.
[94] *Id.*, 504 U.S. at 307.

jurisprudence on the Due Process Clause had evolved since 1967 based on the Court's continual development of the standards of *International Shoe Co. v. Washington*.[95] It determined that the relevant inquiry under the Due Process Clause is whether a defendant had minimum contacts with a state so that the suit against the defendant does not offend traditional notions of fair play and substantial justice.[96] In a due process analysis, the Court no longer relied on formalistic tests that required a defendant's actual presence within the state.[97] Instead, the proper analysis was more flexible and considered whether a remote seller's contacts with the state made it reasonable to subject it to suit in the state's courts.[98] The Court found that this flexible analysis had been extended to all issues of state jurisdiction over out-of-state entities and individuals.[99] Thus, on Quill's due process arguments, the Court found that Quill had purposefully directed its business activities toward North Dakota residents, the magnitude of those contacts was sufficient for due process purposes, and the use tax was related to the benefits that Quill received from the state.[100] Thus, the Court held that the Due Process Clause did not bar North Dakota's imposition of the duty to collect and remit use tax on it and overturned *Bellas Hess* on this point.[101]

**Sustaining *Bellas Hess's* Dormant Commerce Clause Analysis**

While striking down *Bellas Hess'* analysis under the Due Process Clause, the *Quill* Court upheld *Bellas Hess* on the dormant Commerce Clause issue. It determined that the principles of *stare decisis* recommended a continuation of the physical presence rule.[102] Many commentators believe that the doctrine of *stare decisis* was the central reason for the Court's decision to retain the physical presence rule. (Swain I 2003; Swain II 2003; Rothfeld 1992; Hellerstein and Hellerstein 1998 and 2002; Pomp and McIntyre 1996) This is supported by the majority's admission that modern Commerce Clause jurisprudence might not have required the same result if raised for the first time in *Quill*,[103] and the concurrence, in which Justice Scalia, joined by Justices Kennedy and Thomas, argued that the matter should have been decided simply on the doctrine of *stare decisis*.[104]

In upholding the physical presence rule, the Court cited *Complete Auto*'s four-part test to determine whether a state tax should be sustained under the Commerce Clause.[105] The Court distinguished the minimum contacts test applied in the due process analysis from the substantial

[95] 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945)
[96] *Quill*, 504 U.S. at 307, quoting *International Shoe*, 326 U.S. at 316, quoting *Milliken v. Meyer*, 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278 (1940).
[97] *Quill*, 504 U.S. at 307.
[98] *Id*., citing *Shaffer v. Heitner*, 433 U.S. 186, 212, 97 S.Ct. 2569, 2584, 53 L.Ed.2d 683 (1977) ("all assertions of state-court jurisdiction must be evaluated according to the standards set forth in *International Shoe* and its progeny.").
[99] *Quill*, 504 U.S. at 307.
[100] *Id.*, 504 U.S. at 308.
[101] *Id*.
[102] *Id.*, 504 U.S. at 317.
[103] *Quill*, 504 U.S. at 311.
[104] *Id.*, 504 U.S. at 319 (Scalia, J., concurring in part, in judgment); see also Swain, supra, note 104, at 358 ("the three concurring justices seem to take us aside and whisper this sentiment" that the majority opinion was grounded in the doctrine of *stare decisis*.).
[105] See supra. See also *Quill*, 504 U.S. at 310-11, citing *Complete Auto*, 430 U.S. at 279. (The four-part test required the Court to uphold a state's right to tax if: (1) the activity taxed has a substantial nexus with the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is related fairly to the state services provided to the taxed entity.)

nexus requirement in the *Complete Auto* test, finding that a business can have minimum contacts with a taxing state required by the Due Process Clause, but lack the substantial nexus with the state required by the Commerce Clause.[106] The Court also conflated the physical presence rule with the first prong of the *Complete Auto* test, asserting that the physical presence rule meant that a remote seller whose only contact with the taxing state was through mail or common carrier lacked the required substantial nexus.[107] In other words, at least in the sales and use tax context, the first prong of the *Complete Auto* test, substantial nexus required physical presence.

While the Court admitted that it had abandoned formalistic Commerce Clause analysis in *Complete Auto*, it determined that the bright line rule requiring physical presence furthered the ends of the Commerce Clause and created a safe harbor for remote vendors whose only connection with the taxing state was by mail or common carrier.[108] The Court admitted that the physical presence rule appeared "artificial at its edges," but asserted that this artificiality was more than offset by the benefits of having a bright-line rule.[109] It determined that the rule clearly established the limits on states' right to tax out-of-state vendors, reduced litigation, and encouraged settled expectations and investment.[110] It opined that the growth of mail-order businesses after *Bellas Hess* was due, at least in part, to the bright-line physical presence rule.[111] Finally, the majority placed the responsibility of changing the *Bellas Hess* rule, if deemed appropriate, in the hands of Congress.[112]

**The Dissent**

Justice White was the sole dissenter.[113] He agreed with the majority in overturning the Due Process Clause portion of *Bellas Hess*, but believed that the Court should have overturned the entire case.[114] Justice White argued that the majority's finding that the due process minimum contacts test was different from the significant nexus prong of the *Complete Auto* test was completely novel and had never been found before by the Court.[115] He asserted that the cases from which the *Complete Auto* substantial nexus requirement was derived demonstrate that it came from the due process fairness inquiry, not from a completely separate notion of nexus requiring a physical presence in the taxing state.[116]

Justice White further argued that *Complete Auto* disavowed the interpretation of the Commerce Clause in *Bellas Hess* that prohibited states from taxing interstate commerce and cemented the proposition that states are not barred from taxing interstate commerce.[117] In addition, the Court's ruling in *National Geographic* decoupled the notion of a transactional

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106 *Id.*, 504 U.S. at 313.
107 *Quill*, 504 U.S. at 311.
108 *Id.*, 504 U.S. at 314-15.
109 *Id.*, 504 U.S. at 315.
110 *Id.*, 504 U.S. at 315-16.
111 *Id.*, 504 U.S. at 316.
112 *Id.*, 504 U.S. at 318, quoting *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 637, 101 S.Ct. 2946, 2964, 69 L.Ed. 2d 884 (1981).
113 *Quill*, 504 U.S. at 321 (WHITE, J., dissenting).
114 *Id.*, 504 U.S. at 322.
115 *Id.*, 504 U.S. at 325.
116 *Id.*, 504 U.S. at 326-27.
117 *Id.*, 504 U.S. at 322, quoting *Complete Auto*, 430 U.S. 274, 285.

nexus from the Commerce Clause inquiry and repudiated *Bellas Hess*'s free trade rationale for remote sellers.[118]

Justice White argued that the current economy did not require a remote seller to maintain property or personnel in a state to do business there.[119] He questioned what "physical presence" actually meant and whether Quill's activities in North Dakota really showed that it had no physical presence.[120] He predicted that determining the meaning of "physical presence" would result in an increase in litigation.[121] Remote sellers like *Quill* still relied on the commercial benefits offered by the state in which they do business, including banking laws, the court system (for collections cases), waste disposal for the garbage created by mail order solicitations and packages, and consumer protection laws enacted for the protection of both consumer and vendor.[122] Does this constitute physical presence sufficient for Commerce Clause purposes?

He stated bluntly that the physical presence requirement was anachronistic in economic terms, illogical, and unfair.[123] He disagreed with perpetuating a rule that created an interstate tax shelter for mail order businesses, which at that time was a $180 billion-a-year industry, but provided no advantage to their competitors.[124]

Justice White argued that retaining the physical presence rule on *stare decisis* grounds was not necessary and fears that states would impose retroactive tax liability absent the rule were groundless.[125] He dismissed the value of industry reliance on the physical presence rule, particularly in light of the changing Commerce Clause analysis in recent cases.[126] Quill's reliance, in particular, he found unreasonable, especially in light of Quill's refusal to pay the tax and then challenge it in court.[127]

Finally, Justice White argued that, while Congress should act in this area, the Court's continued adherence to the *Bellas Hess* decision in light of recent cases and economic realities was not justified.[128]

### The Second Direct Challenge to the Physical Presence Rule

Since 1992 when the *Quill* Court upheld the physical presence rule, commentators have recommended that the Court revisit the issue and reject the rule. (Swain II 2003) In 2015, in his concurrence to *Direct Marketing Association v. Brohl,* Justice Kennedy urged his colleagues and the legal system to find a case in which the Court could reconsider *Quill* and *Bellas Hess* because of the harm and unfairness caused to the states by their inability to collect revenue and changes in technology and consumer sophistication.[129] Not long after, South Dakota appealed its state supreme court's ruling in its suit against Wayfair, Inc. and others to the U.S. Supreme Court, asking the Court to invalidate the physical presence rule.

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[118] *Quill,* 504 U.S. at 324.
[119] *Id.*, 504 U.S. at 328.
[120] *Id.*, 504 U.S. at 330.
[121] *Id.*, 504 U.S. at 331.
[122] *Id.*, 504 U.S. at 328.
[123] *Id.*, 504 U.S. at 328-29.
[124] *Id.*, 504 U.S. at 329, citing Brief for State of New Jersey as *Amicus Curiae* 4.
[125] *Id.*, 504 U.S. at 331, 332.
[126] *Id.*, 504 U.S. at 331.
[127] *Id.*, 504 U.S. at 332.
[128] *Id.*
[129] 575 U.S. __, 135 S. Ct. 1124, 1134-1135, 191 L.Ed. 2d 97 (2015) ("it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*.") (Kennedy, J. concurrence).

***South Dakota v. Wayfair, Inc.***

*Wayfair*[130] was decided on June 21, 2018, 26 years after *Quill* and 51 years after *Bellas Hess*. In a 5-4 decision, the Supreme Court rejected the physical presence rule and overruled *Quill* and *Bellas Hess*. Justice Kennedy wrote the majority opinion and was joined by Justices Thomas, Ginsberg, Alito, and Gorsuch.[131]

In 2016, a short time after Justice Kennedy's concurrence in *Direct Marketing,* South Dakota enacted an Act in S. 106[132] with the express goal of judicially challenging the physical presence rule and the state's inability to tax remote sellers, which it had determined was causing a decrease in critical funding for state and local services.[133] (Howsare 2017) The Act was dubbed a "kill-*Quill* law" by some commentators. (Howsare 2017) South Dakota also declared an emergency based on the revenue lost from its inability to tax remote sellers, which it argued was necessary to support the state government and public institutions.[134]

In response to the concerns raised in *Bellas Hess* and *Quill* that subjecting remote sellers to sales and use taxes could result in an undue administrative burden,[135] the Act was specifically limited in its application to remote sellers that delivered more than $100,000 of goods or services in state each year or engaged in 200 or more in-state transactions.[136] In addition, South Dakota is a member of the Streamlined Sales and Use Tax Agreement developed by a number of states in 2000 to simplify and modernize sales and use tax administration to substantially reduce the burden of sales and use tax compliance, including by simplifying the payment of both state and local taxes.[137] This membership would provide remote sellers with resources to simplify the payment of state and local taxes.[138] The Act also provided for a stay of its effect until constitutional issues could be determined and prevented retroactive application, another attempt to quell the Court's concerns.[139]

South Dakota filed a declaratory judgment action against respondents Wayfair, Inc., Overstock.com, Inc., and Newegg, Inc., all remote sellers with substantial sales and transactions in the state, arguing that these sellers should be required to collect sales tax from their in-state sales under the Act.[140] Both the trial court and state supreme court granted summary judgment to respondents, and the U.S. Supreme Court granted certiorari.[141]

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[130] U.S., No. 17-494 (June 21, 2018) (slip opinion).
[131] *Wayfair*, at 4-6.
[132] *Id.*, at 8, citing S. 106, 2016 Leg. Assembly, 91st Sess. (S.D. 2016).
[133] *Wayfair*, at 8, citing S. 106, §8(1).
[134] *Wayfair*, at 8, citing S. 106, §9.
[135] See *Bellas Hess*, at 759; *Quill*, at 314-316, 318.
[136] *Wayfair*, at 8, citing S. 106, §1.
[137] Streamlined Sales Tax Governing Board, Inc., "State Guide to the Streamlined Sales Tax Project: An Overview and Guide for State Lawmakers and Tax Administrators Explaining the Streamlined Sales Tax Project," at 3 (May 3, 2018).
(http://www.streamlinedsalestax.org/uploads/downloads/Forms/State%20Guide%20to%20Streamlined%20Sales%20Tax%20Project%202018-5-18.pdf).
[138] *Wayfair*, at 28.
[139] *Id.*, at 8, citing S. 106, §§3, 5, 8(10); see *Quill*, 504 U.S. at 332 (J. White, dissenting).
[140] *Wayfair*, at 8-9.
[141] *Id.*, at 9.

The Court determined that *Quill* was flawed.[142] The Court set forth the history of the dormant Commerce Clause, particularly as related to state taxation of interstate commerce, in a sweeping analysis of the Court's jurisprudence in the area since the U.S. Constitution was enacted.[143] It detailed the criticism leveled against the physical presence rule.[144] It found that the reasons the *Quill* Court gave for rejecting the application of the physical presence rule to the minimum contacts test of the Due Process Clause equally applied to rejecting it for the substantial nexus test in the Commerce Clause.[145]

The Court scorned the finding in *Quill* that the complexities of complying with multiple state and local taxes might unduly burden sellers with no physical presence in a state, particularly as out-of-state sellers with a physical presence in a state were required to shoulder that burden.[146] The physical presence rule was a poor means to address compliance costs faced by remote sellers that do business in multiple states, and other aspects of Commerce Clause doctrine could deal with any potential burdens on interstate commerce better and more accurately than the physical presence rule.[147]

The Court also found that the physical presence rule interfered with states' lawful authority to collect taxes and perform critical public functions.[148] In addition, the physical presence rule put sellers with a physical presence in a state at a competitive disadvantage and resulted in a judicially created tax shelter for remote sellers.[149] It found that the rule produced distorted business decision-making by creating an incentive for remote sellers to avoid physical presence in a state.[150] It determined that the rule undermined public confidence in the tax system and was unfair and unjust to states, competitors of remote sellers that had a physical presence, and customers who paid sales tax in the state.[151]

The Court also determined that the *Quill* Court ignored the rejection of formalism in the Court's Commerce Clause jurisprudence and the embrace of a more functional analysis of market dynamics.[152] *Quill* was wrongly decided even with regard to the less complex economic realities in 1992.[153] The Court also dismissed as unsound the argument that the physical presence rule is easy to apply, finding that the prevalence of e-commerce made determining what constitutes physical presence more and more difficult.[154] In light of modern day e-commerce the definition of physical presence was unclear, particularly given the virtual presence that online marketers have in customers' computers and smart phones through apps and cookies and in data storage facilities located in-state.[155] The Court predicted that, given present day economic realities, if left to continue, the physical presence rule would result in increasing litigation on the meaning of "physical presence."[156]

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142 *Id*.
143 *Id.*, at 10-15.
144 *Id.*, at 15.
145 *Id.*, at 16.
146 *Id.*, at 17.
147 *Id.*
148 *Id.*, at 21.
149 *Id.*, at 18.
150 *Id*.
151 *Id.*, at 21-22.
152 *Id.*, at 18-19.
153 *Id.*, at 23.
154 *Id.*, at 24-25.
155 *Id.*, at 20.
156 *Id.*, at 25.

The Court dismissed the idea that the doctrine of *stare decisis* required it to uphold *Quill*, finding that s*tare decisis* could not support the physical presence rule because the rule unconstitutionally infringed on states' sovereign powers.[157] While the Court found that reliance interests could be legitimate considerations in deciding whether to uphold Court precedent, the arguments for reliance based on the physical presence rule were not.[158]

The Court conceded that Congress had the authority to reject or alter the physical presence rule; however, Congress did not have the authority to change a constitutional default rule established by the Court.[159] Further, given that the "false constitutional premise" of the physical presence rule was judicially created and through it the Court was limiting the lawful authority of the states, the Court could not rely on Congress to change the law but must reject the rule itself.[160] Indeed, while Congress had introduced legislation in 2018 to overturn the physical presence rule and at other times during the five decades it was in effect, it did not pass it.[161] (Swain II 2003)

The Court discounted the difficulties that small businesses and start-ups may have with complying with state and local taxes.[162] It determined that software and other systems have been and will continue to be developed to help businesses comply.[163] Further, the South Dakota Act, by its terms, applied only to remote sellers doing a large amount of business in South Dakota.[164] In addition, the Court found that in the absence of the physical presence rule, the dormant Commerce Clause and the four-pronged *Complete Auto* test would continue to protect businesses from any actual undue burden on interstate commerce.[165]

After overruling *Quill* and *Bellas Hess* and invalidating the physical presence rule, the Court determined that there was a substantial nexus between the activities of the respondents and South Dakota; therefore, the Act passed the substantial nexus prong of the *Complete Auto* test.[166] With regard to the remaining three prongs of that test, which the parties had not litigated or briefed, the Court determined that it need not resolve them.[167] On that basis, the Court vacated the decision of the state supreme court and remanded the case for further proceedings.[168] However, it also listed features of the South Dakota Act that appeared to be designed to prevent undue burdens or discrimination on interstate commerce: (1) the Act provides a safe harbor for businesses with limited or intermittent sales in the state; (2) the language of Act prevented retroactive application; and (3) South Dakota is a member of the Streamlined Sales and Use Tax Agreement.[169]

[157] *Id.*, at 22.
[158] *Id.*, at 25.
[159] *Id.*, at 22-23.
[160] *Id.*, at 23.
[161] See *Quill*, 504 U.S. at 318, n. 11 (listing bills introduced in Congress).
[162] *Wayfair*, at 25-26.
[163] *Id.*, at 26, 29.
[164] *Id.*, at 26. See also, S. 106, §1.
[165] *Wayfair*, at 26
[166] *Id.*, at 27-28.
[167] *Id.*, at 28.
[168] *Id.*, at 28-29
[169] *Id.*, at 28. See also the description of the Streamlined Sales and Use Tax Agreement, supra.

### The Concurrences

Justice Thomas and Justice Gorsuch separately concurred.[170] Justice Thomas reflected that he should have joined Justice White's dissent in *Quill*.[171] He asserted that the whole of the dormant Commerce Clause jurisprudence could not be justified rationally.[172] Justice Gorsuch also quoted Justice White's dissent with approval, opining that the physical presence rule created a discriminatory tax shelter for remote sellers.[173] He also hinted that he disagreed with aspects of the dormant Commerce Clause, but left that as "questions for another day."[174]

### The Dissent

Chief Justice Roberts, joined by Justices Breyer, Sotomayor, and Kagan, dissented from the majority opinion.[175] Justice Roberts agreed with the majority that *Bellas Hess* was wrongly decided[176]; however, he argued that rejecting the physical presence rule could disrupt the economy.[177] He asserted that the doctrine of *stare decisis* is heightened in dormant Commerce Clause cases because Congress has the power to decide the underlying issue.[178] He noted that three bills on this issue were pending in Congress and opined that Congress could better resolve the situation than the Court.[179] He cited to information that states are already able to collect 80 percent of the tax revenue that would be available without the physical presence rule,[180] and argued that rejecting the physical presence rule would impose costs on remote sellers, with the burden falling mainly on small businesses.[181]

## The Potential Consequences of *Wayfair*

The potential consequences of the *Wayfair* decision are speculative, though some are highly probable. First, rather than settle the law in this area, *Wayfair* will likely lead to increased litigation as more states impose duties to collect sales and use taxes on remote sellers. Some states may try to expand the substantial nexus requirement from the limits in the South Dakota law to increase tax revenues. Remote sellers eager to limit substantial nexus will file numerous lawsuits to test states' unique sales and use tax laws. As the Supreme Court is unlikely to further clarify the limits of substantial nexus anytime soon, the minimum requirements are likely to be the subject of years of litigation in the lower courts before the issue is settled.

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[170] *Id.*, at 30 (Thomas, J., concurring); 31 (Gorsuch, J., concurring).
[171] *Id.* (Thomas, J., concurring)
[172] *Id.* (Thomas, J., concurring), quoting *Quill*, 504 U.S. at 333 (White, J., dissenting).
[173] *Id.*, at 31 (Gorsuch, J. concurring), quoting *Quill*, 504 U.S. at 333 (White, J., dissenting).
[174] *Id.*, at 31-32 (Gorsuch, J., concurring).
[175] *Id.*, at 33 (Roberts, J., dissenting).
[176] *Id.*, at 34 (Roberts, J. dissenting).
[177] *Id.*, at 33 (Roberts, J. dissenting).
[178] *Id.*, at 34-35 (Roberts, J. dissenting).
[179] *Id.*, at 36, 39 (Roberts, J. dissenting).
[180] *Id.*, at 37 (Roberts, J. dissenting).
[181] *Id.*, at 37-39 (Roberts, J. dissenting). .

Second, Congress may choose to address the issue through legislation, despite its past failure to do so even in the face of encouragement by the Supreme Court.[182] As noted by Chief Justice Roberts in his *Wayfair* dissent, three bills were pending in Congress on this issue at the time of the decision.[183] However, instead of sidelining this issue in Congress, as he feared, *Wayfair* may push remote sellers to lobby for legislation preventing states from imposing these taxes on them and may push states to seek Congressional guidance on the limits of such taxation. Decisive congressional action could prevent much of the anticipated litigation on the limits of the substantial nexus requirement; of course, there is no guarantee that Congress will act.

Third, many states may simply copy South Dakota's statute to avoid litigation. *Wayfair* provides three safe harbors to assist states in meeting the substantial nexus requirement and provide remote sellers with "a reasonable degree of protection."[184] First, the *Wayfair* majority cited with approval the limitations on the applicability of the South Dakota law, gross revenue of over $100,000 and 200 or more separate transactions.[185] Second, the South Dakota law expressly prohibits retroactive application.[186] Third, the Court cited South Dakota's membership in the Streamlined Sales and Use Tax Agreement ("Agreement") with approval.[187] Lower courts are likely to find that state statutes that include the same or higher limits and prohibit retroactive application in states that are members of the Agreement meet the requirements for substantial nexus, fulfilling the first prong of the *Complete Auto* test.

It is less likely that there will be significant litigation brought under the remaining three prongs of the *Complete Auto* test – whether the tax is fairly apportioned, whether it discriminates against interstate commerce, and whether it is fairly related to services provided by the state. Numerous cases applying *Complete Auto* to other types of state taxes have established settled rules to help states navigate these waters.

To comply with the fair apportionment requirement,[188] the state tax must be both internally consistent[189] and externally consistent.[190] If the law requires the remote seller to collect only the sales or use taxes imposed on sales made to residents within its borders, the tax is likely to be considered fairly apportioned. Internal consistency would exist because, if other states imposed identical sales taxes only on sales made within their borders, there would be no double taxation. External consistency would also exist because the state would tax only sales made by the remote seller to state residents.

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[182] See e.g., *Quill*, 504 U.S. at 318, quoting *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 637, 101 S.Ct. 2946, 2964, 69 L.Ed. 2d 884 (1981); *Id*., at 321 (WHITE, J., concurring); *Wayfair*, at 33-40 (Roberts, C.J. dissenting).

[183] *Wayfair*, at 36 ("[B]y suddenly changing the ground rules, the Court may have waylaid Congress's consideration of the issue.") (Roberts, C.J. dissenting).

[184] *Id.*, at 26.

[185] *Id*.

[186] S. 106, §5.

[187] *Wayfair*, at 26.

[188] *Goldberg*, 488 U.S. at 260-61 ("the central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction.").

[189] *Id.*, 488 U.S. at 261 ("To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result. [citation omitted] Thus, the internal consistency test focuses on the text of the challenged statute and hypothesizes a situation where other States have passed an identical statute.").

[190] *Id.*, 488 U.S. at 262 ("The external consistency test asks whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed.").

To prevent discrimination of interstate commerce, the state must avoid making distinctions in applying the law to in-state and remote sellers. If an identical tax burden is placed on both remote and in-state sellers – the same amount of tax, the same collection duties, the same reporting and recordkeeping requirements, etc. – the courts will likely find that the tax does not discriminate against interstate commerce.[191]

To be reasonably related to services provided by the state, the measure of the tax must be in proportion to the taxpayer's activities in the state, such as a percentage of the monetary amount of sales made to state residents by the taxpayer.[192]

If a state's law remains within the safe harbors in *Wayfair* for the substantial nexus prong and complies with the three additional requirements in *Complete Auto*, it is highly unlikely that the law will be found to discriminate against interstate commerce.

Finally, following *Wayfair*, state sales and use tax statutes may become more uniform and collection less onerous. The Agreement is intended to help states simplify and streamline sales and use tax administration and reduce the burden of compliance.[193] It provides free assistance of certified service providers and free software to help sellers comply with sales and use tax laws and assist in audits, and sellers who use those services are immune from many types of liability.[194] Given the Court's positive response to the Agreement, more states are likely to join, making uniformity and ease of collection more likely.

## Conclusion

Over the past 51 years, the Supreme Court's development of dormant Commerce Clause jurisprudence for the application of states' sales and use taxes to remote sellers has been blind to the dramatic changes to the economy during that period. When the Supreme Court decided *Bellas Hess* in 1967, based on the formalistic jurisprudence of the day, states' authority to impose state sales and use taxes on sales made by sellers in interstate commerce was flatly and completely denied through the physical presence rule. Further, at that time sales by remote sellers were not a large part of the economy, meaning that states' revenues were only minimally impacted by the rule. However, by 1977, the Court recognized in *Complete Auto* that a more realistic interpretation of the dormant Commerce Clause relating to state taxation was necessary, and formalistic analyses was rejected. The *Quill* Court skirted this change in the law and upheld the formalistic flat denial imposed by the physical presence rule on *stare decisis* and other grounds, notwithstanding the major changes in the mail order industry that had been made by that time. Finally, in *Wayfair*, the Supreme Court struck down the physical presence rule, restoring equity to the application of sales and use taxes and recognizing states' sovereignty and

[191] *Armco Inc v. Hardesty*, 467 U.S. 638, 642, 104 S.Ct. 2620, 81 L.Ed.2d 540 (1984) (the third *Complete Auto* test prong that requires that a state tax may not discriminate against interstate commerce means that "a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State.")

[192] *Commonwealth Edison Company*, 453 U.S. at 626-27 ("the fourth prong of the Complete Auto Transit test imposes the additional limitation that the measure of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a just share of state tax burden. … When a tax is assessed in proportion to a taxpayer's activities or presence in a State, the taxpayer is shouldering its fair share of supporting the State's provision of police and fire protection, the benefit of a trained work force, and the advantages of a civilized society.") (internal quotations and citations omitted).

[193] See Streamlined Sales Tax Governing Board website, "What is the purpose of the Streamlined Sales and Use Tax Agreement?" (https://www.streamlinedsalestax.org/index.php?page=gen3).

[194] *Id.*, "What are the benefits of using a Certified Service Provider?" (https://www.streamlinedsalestax.org/index.php?page=csps3).

authority to tax commerce carried on within their boundaries. This decision will provide states with the means to increase their sales and use tax revenues from remote sellers within the reasonable boundaries of the dormant Commerce Clause, but will likely result in increased litigation as states and remote sellers test the boundaries of substantial nexus. In addition, Congress will be under increased pressure from interest groups to clarify states' ability to impose sales and use tax collection duties on remote sellers. Finally, more states are likely to join the Streamlined Sales and Use Tax Agreement based on the Court's tacit approval, which may result in greater uniformity in states' laws and reduced burdens of compliance by remote sellers.

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